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Foe and Friend are Beginning to Recognize the Key Forgotten Role of the Central Bank

To unions:

Further to my earlier letters advocating use of the Bank of Canada to carry public debt, you will be interested in the report from the C.D. Howe Institute, now recommending the same. Although the Institute's goal is limited to getting more cash into financial institutions, the process is the same for getting interest-free cash to our three levels of government to invest in public works of all kinds. It fits in with the goal of stimulating the economy to provide good jobs for all workers. It also lessens the influence lenders have on government policy – making it easier for social policies to be adopted. – Richard Priestman

Well! Wha'd'ya know? Even the C.D. Howe Institute says the Bank of Canada should buy Government of Canada securities (C.D. Howe Monetary Policy Council report – 16/4/09), or to put it another way the government should borrow from the Bank of Canada. When the government sells a bond it is borrowing from the purchaser of that bond, and when the government borrows from the Bank of Canada there is effectively no interest on that debt because interest paid comes back to the government as dividend. In this way, the government can borrow whatever is necessary to get the economy moving again without hanging a huge debt burden on the necks of future generations. We pay enough interest now on the debts of our three levels of government (over $63-billion a year) for money borrowed privately instead of from the Bank of Canada. We don't need any more privately financed public debt!

"A strong majority" of the Monetary Policy Council "favoured purchases of Government of Canada securities…rather than purchases of private securities." While their goal is more cash for financial institutions, the same procedure can be used to provide cash for our three levels of government to invest in public services such as housing, infrastructure, education, research, the CBC, health care, recreation facilities, etc. Investments of this nature provide big dividends, some of the biggest coming from education and research. Among others who support government investment in public works to get out of the recession is David Dodge (former Governor of the Bank of Canada).

With unemployment climbing by the tens of thousands in a month, much more needs to be done than is. Some will balk at the thought of taking on more debt, not fully understanding that investments in public service using interest free money pay off in future dividends. Others balk at it because of an ideological commitment to smaller government and privately run services. Public financing of public works not only would make it possible to do what needs to be done, it would also lower taxes and, *more importantly, reduce the influence of lenders on government!* The legislation for using the Bank to finance government debt exists in the *Bank of Canada Act.*

Key Institution for Economic Recovery is Being Rediscovered

Now that the C.D. Howe Institute supports use of the Bank of Canada to buy government securities, maybe the CCPA (Canadian Council on Public Policy) will say more about it.[1] They used to include a statement on it every year along with their "alternative budget," but have said very little

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How the World Economy was Sucked Down the Drain

Alan S. Blinder is a professor of economic and public affairs at Princeton and former vice chairman of the Federal Reserve in the US. He has advised many Democratic politicians. That is why his article in *The New York Times* (12/04, "Restore Order and Win a War") frightens the bejeezus out of one, for the sheer ignorance just what is behind the "big words" in our current ever-deepening world crisis. The fact that he claims to be – and may well be – concerned about the fate of the downtrodden in a sense only curdles the confusion yet further. However, let us begin – out of respect as it were – of his high academic post at one of the US's top universities.

"It is maddening that hardly any of the miscreants have been punished, to mention that many remain well paid. But foolishness is not a crime, and most of them broke no laws. Perhaps worse, a host of safeguards supposed to protect us – from corporate boards and rating agencies to regulators and elected officials – all failed adding insult to injury. Hardly anyone has apologized for the disaster or even explained how we got into it and how we plan to get out.

"Let me try the latter.

"In the bubble era, even sophisticated people deluded themselves into believing that home prices would soar indefinitely and that lending risks were minimal. On those weak foundations, a huge house of cards was built. Wall Streeters designed a hideously complex financial system to enrich themselves. Financial institutions took on far too much debt. People signed mortgages they could ill afford and did not understand. Regulators, the Bush administration and Congress looked the other way. The bubble grew until it burst.

"Much of this shouldn't have happened. But we are where we are, and the urgent priority is to extricate ourselves from this mess as quickly as possible, with minimal damage. Here is how I conceptualize the master plan.

"American policy makers are fighting a two-front war. On the eastern front, they are battling a shortage of demand, as traumatized householders and businesses pull in their horns."

That would make it a three-front war, wouldn't it since there is a real non-metaphorical war under way reinforced by President Obama. What a strange metaphor to choose, as though to add further to what is already adequate confusion. But let us continue our quotation.

"Less spending by some people means fewer jobs for others who, in turn, curtail their own spending. Keynes diagnosed this vicious recessionary spiral in the 1930s, and we are not in the worst one since then.

"Fortunately, we know how to fight a demand shortage – with more government spending, tax cuts and lower interest rates. That is not to mention the non-metaphorical war the scope of which is being enlarged in Afghanistan and neighboring states. Strange omission.

"The Western front is vastly more complex. All economies run on credit, and cuts developed an extreme dependence. Largely through their own failings, banks have been seriously damaged. Bankers are paralyzed by fear of further loan losses and shrinking capital that might subject them to regulatory penalties – or worse. One way or another, the banks must be restored to health and emboldened to lend."

Banks Need Capital As Well As Government Loans

"Now the Fed has made huge loans to banks and flooded them with cash. But the banks also need capital, and private money is not stepping up to the plate. That was why Henry M. Paulson Jr., the former Treasury secretary, decided to devote the Troubled Asset Relief Program to injecting capital into banks last fall. I disagreed with both his decision and the way in which he executed it. But there was a rationale for what he did, and the current Treasury secretary, Timothy F, Geithner, will eventually be back for more money for this purpose.

"But banks are just part of the problem. Much modern lending is securitized by the so-called shadow banking system – a complex web of interlocking, sometimes mysterious capital markets. Invisible to most people, it is crucial to getting credit to mortgagees, credit card holders and businesses. And while the financial implosion wounded the banks, it decimated the shadow banking system.

"The most obvious – but not the only –

disasters stem from mortgage delinquencies, fears of more, and consequent uncertainty about the values of mortgage-related securities. Bringing these markets back to life is one rationale for both the administration's foreclosure mitigation programs and its public-private investment programs. It is also a principal rationale for many of the Fed's unprecedented lending and money-creation activities.

"Thus the war plan has four essential components that hang together logically: stimulating aggregate demand, limiting foreclosures, rescuing (most of) the banks and rehabilitating the shadow banking system. Three of the four are in place. We await Mr. Geithner's bank rescue plan, which, I hope, will be some version of the good bank-bad bank idea I mentioned here last month.

"Unfortunately, the administration seems to have a penchant for complexity in designing its programs, and I certainly would not defend all the details. But it's essential that citizens see through the trees to the forest. All this taxpayer money is being put at risk for a good, simple reason: victory in a two-front war requires winning on both fronts. We won't defeat the recession unless we restore some financial order.

"Countries do unpalatable things in wartime, and collateral damage is common. So it is here. The impending federal budget deficits are monstrous. The Fed is printing money like mad. People who deserve punishment are receiving help instead. The government's investment partnerships may enrich some investors.

"There will be time to address these problems later. For now, the nation must focus single-mindedly on winning the war. There really is a plan."

It is apparent why Prof. Blinder not only failed to mention the extension of the Afghan War that is already under way, but borrowed the "war" metaphor to smudge his picture of the Fed "printing money like mad." How would the Professor know without anything that could merit being called "accountancy?"

First of all, the US dollar has – more than any other currency – become the world reserve currency, and what the Fed rather than the banks create is still gobbled up by most foreign countries.

Second, the US left the gold standard at the beginning of the 1970s. Since then, the only legal tender the US has or can create is its government debt. It would make far more sense if the Federal reserve issued more that government debt rather than relying on the banks to create it as bank credit, or even to raise it as government bonds, which bring the banks and their brokerages into the process and not only expose the government to bank brokerage and other charges. It also diverts the resources of the banks from looking after the needs of private businesses to handling government bonds. It puts the government into competition with private producers who are also going broke in droves for lack of bank credit.

Third, when Roosevelt was inaugurated for his first term one of the first things he did was to bring in the *Glass-Steagall* law that forbade banks to acquire interests in the "other financial pillars." For once they acquired interests or took over these non-banking financial pillars – stock brokerages, insurance, and mortgage firms, they took over the cash reserves of these firms that these other holders required for their own businesses, and used them for their own near-money creation.

Moving from one such take-over situation of these non-banking pillars, what resulted was an ever rising skyscraper with elevators that could only move upward – never, ever down and ever faster. That in essence is what happened. Without the growing disregard of the *Glass-Steagall* law during the 1980s there would never had been the huge bank failures of the 1980s when the US banks moved in and took over the Savings and Loans – mortgage trusts in essence. Nor could have there been the subprime mortgage crisis.

Yet Professor Blinder does not breathe a word about the connection, nor about the renewal of the *Glass-Steagall* legislation as an essential part of the cure.

Fourth, in the early 1990s when the North American Free Trade Agreement had mated Mexican-scale corruption with the mammoth greed of deregulated US banking, the Bank for International Settlements – a sort of central bankers' war room dedicated to achieving the deregulation of banks – had declared the debt of developed countries risk-free and hence available to central banks without down-payment. A few years later however, the same BIS pressured its members to raise interest rates until the price level of the country became actually flat. In its zeal it overlooked the detail that when interest rates shoot up the market price of preexistent bonds with lower interest rates falls like a rock. That almost precipitated an international banking crisis. On Washington's initiative, the largest standby fund to that date was raised – $51 billion – to forestall world currency collapse and save the situation. But the glimpse of the precipice on the brink of which the world was tottering convinced the Clinton government that the age of high interest rates could not go on.

To bring down interest rates, Clinton introduced serious accounting into his government's books. Accrual accountancy – brought back by a Crusader order from Arab lands about a thousand years ago, required that every transaction be entered into a company or even private ledger twice – once the amount spent to acquire or develop the investment. This was "amortized" over the period that the investment so financed was expected to serve. And the resulting capital physical assets were "depreciated" over the expectant period of usefulness. Private firms and even individuals are expected to use this double-entry accountancy. But not the government itself.

With the exception of the odd Scandinavian country for short periods, no country has amortized the debt conscientiously, but depreciated the physical assets resulting from the investment wholly in a single year. What resulted was a government debt on the books that was not really there. That debt served those in the saddle better than the best stirrups. Social programs could be turned down – as at present – because it is claimed we cannot cope with our growing budgetary deficit.

Forgotten *from page 1*

in this regard for the past several years. The Council of Canadians adopted a resolution on this at their 1994 annual meeting, but never acted on it. Likewise the NDP adopted a resolution on it at their leadership convention in 1995, then promptly ignored it. Maybe it, too, will talk about it. Maybe even the Liberals and Conservatives will support the idea. And maybe the CLC (Canadian Labour Congress) will talk about it at the rallies they are organizing all across the country in their "campaign for change."

If enough Canadians say that public debt should be financed by our public bank, the political party(s) which support this policy will have the best chance of getting elected at the next federal election.

Richard Priestman

1. The CCPA has changed its policy in a big way. William Krehm has been asked by its editor in chief to contribute an article on the subject.

The drop in interest rates gave Clinton his second term and ignited a stock market boom that extended until the high-tech bust of 1998. Carried back to 1959 something like $1.3 billion of assets were retrieved out of the void.

Investing in Human Capital Will Put an End to the Deepening Depression

But there is a far greater amount of government investment in human capital that still is written off as a current expense. After WWII Washington had sent hundreds of economists to Japan and Germany to study the destruction during the war and predict how long it would be before those two defeated countries could once again become formidable competitors on world markets. 16 years later one of these, Theodore Schultz, concluded that he and his colleagues had made a faulty forecast because they had concentrated on the *physical* destruction during the war, and overlooked the importance of the highly educated and disciplined working force that had survived intact. Schultz concluded that government investment in human capital – which of course would have to include the environment – was the most productive investment a government could make. Schultz was feted and decorated for a very few years and then completely forgotten.

However, what he taught us was never more important than today. Allowing for the movement of prices since the early 1990s, the value of unrecognized human capital on the books of the US government could not possibly be less than a trillion dollars, and in the case of Canada some $300 billion. But human capital has some very special aspects. In most cases its very "expenditure" is an investment itself. The children of educated parents tend to be easier to educate. Britain is still receiving dividends on what little money England spent on teaching Billy Shakespeare about language and literature, or teaching Izzy Newton algebra.

Why do not the professors of this world join us in asking that that the same recognition already granted physical investments by government be extended to human investments. And instead of having that precious reserve piddled away by the banks in their gambles, that it be handled by the central bank?

It is really time that we become serious about coming to grips with our banking crisis.

William Krehm

Obama a Fresh Coat of Paint for Wall Street's Old Habits?

We were shocked into just that belief, reluctantly, but asked ourselves whether mendacious promotion could really reach such virtuosity, when in came that grand old *New York Times* guns ablaze (27/04, "Money for Nothing" by Paul Krugman): "On July 15, 2007, *The New York Times* published an article with the headline 'The Richest of the Rich, Proud of a New Gilded Age.' The most prominently featured of the 'new titans' was Santiago Weill, the former chairman of Citi-group, who insisted that he and his peers in the financial sector had earned their immense wealth through their contributions to society.

"Soon after that article was printed, the financial empire Mr. Weill took credit for helping to build collapsed, inflicting immense collateral damage in the process. Even if we manage to avoid a repeat of the Great Depression, the world economy will take years to recover from this crisis.

"All of which explains why we should be disturbed by an article in Sunday's *Times* reporting that pay at investment banks, after dipping last year, is soaring again – right back to 2007 levels.

"Why is this disturbing? Let me count the ways.

"First, there's no longer any reason to believe the wizards of Wall Street actually contribute anything positive to society, let alone enough to justify those humongous paychecks.

"Remember that the gilded Wall Street of 2007 was a fairly new phenomenon. From the 1930s until 1980 banking was a staid, rather boring business that paid no better, on the average, than other industries, yet kept the country's wheels turning.

"So why did some bankers suddenly begin making vast fortunes? It was, we were told, for their creativity – for financial innovation. At this point, however, it's hard to think of any major recent innovations that actually aided society, as opposed to being new, improvised ways to blow bubbles, evade regulations and implement Ponzi schemes.

"Consider a recent speech by Ben Bernanke, the Federal Reserve Chairman, in which he tried to defend financial innovation. His examples of 'good' financing innovations were (1) credit cards – not exactly a new idea; (2) overdraft protection; and (3) subprime mortgages. (I am not making this up.) These were the things for which bankers got paid the big bucks?

"Still, you might argue that we have a free-market economy, and it's up to the private sector to decide how much its employees are worth. But that brings me to my second point: Wall Street is no longer, in any real sense, part of the private sector. It is a ward of the state, every bit as dependent on government aid as recipients of Temporary Assistance for Needy Families, a.k.a. 'welfare.'

"I'm not just talking about the $600 billion or so already committed under TARP. There are also huge credit lines extended by the Federal Reserve; large-scale lending by Federal Home Loan Banks; the taxpayer-financed payoffs of AIG contracts; the vast expansion of FDIC guarantees; and, more broadly, the implicit backing provided to every financial firm considered too big, or too strategic, to fail.

"One can argue that it's necessary to rescue Wall Street to protect the economy as a whole – and in fact I agree. But given all that taxpayer money on the line, financial firms should be acting like public utilities, not returning to the practices and paychecks of 2007.

"Furthermore, paying vast sums to wheeler-dealers isn't just outrageous; it's dangerous. Why, after all, did bankers take such huge risks? Because success – or even temporary appearance of success – offered such gigantic rewards: even executives who blew up their companies could and did walk away with hundreds of millions. Now we're seeing similar rewards offered to people who can play their risky games with federal backing.

"So what is going on here? Why are paychecks heading for the stratosphere again? Claims that the banks have to pay these salaries to retain their best people aren't plausible: with employment in the financial sector plunging, where are these people going to go?

"No, the real reason financial firms are paying big again is simply because they can. They're making money again (although not as much as they claim), and why not? After all, they can borrow cheaply, thanks to all these federal guarantees, and lend at much higher rates. So let's eat, drink and be merry, for tomorrow you may be regulated.

"Or maybe not. There's a palpable sense in the financial press that the storm has passed: stocks are up, the economy's nose-dive may be leveling off, and the Obama administration will probably let the bankers off with nothing more than a few stern speeches. Rightly or wrongly, the bankers seem to believe that a return to business as usual is just around the corner.

"We can only hope that our leaders prove them wrong, and carry through with real reform. In 2008, overpaid bankers taking big risks with other people's money brought the world economy to its knees. The last thing we need is to give them a chance to do it all over again."

To assure that we must learn and apply the key concept of a great French economist, François Perroux, dead for some two decades, and near-forgotten even in France itself – the "dominant revenue." In every society, it tells us, the revenue of an empowered class is taken – by its rate or absolute volume – as the index of the well-being of the society as a whole. After the Napoleonic Wars in Britain, for example, the British tariffs were kept high, so that great landowners could gouge maximum prices for even the subsistence wages of the working class. It was in the interest of the rapidly rising industrialists to reduce those tariffs so that they could lower those subsistence wages further, and reinforce their mission of convincing the relatively non-industrialized world that was to everybody's advantage. Then industrialization having made great strides on most continents, protectionism came in again. Today the dominant revenue is that of speculative banking, and it has buttressed its position by cleansing the economic faculties of most universities of a knowledge of our history and of the history of economic theories.

That makes the wildly irresponsible behavior of government and central banks fit like a glove with what is happening with our relentlessly deepening crisis.

William Krehm

Does Saving the Auto Industry Unwittingly Mimick Attempts to Guide the Economy Before the Money Concept was Developed?

Many readers of our April issue may have been puzzled by our long article based on a German scholarly work tracing the attempts to provide and manage credit and the products it made possible before the concept of money had even evolved. Our source was the first of a three-volume scholarly work in German *Deutsche Bankengeschichte* by Professor Ernst Klein and other associates, and is published by Fritz Knapp Verlag, Frankfurt am Main, Germany.

Let me cite a few salient passages to indicate how much of the rather obtuse efforts of Washington to rescue the auto business, is ending up putting the state, and/or merchant bankers who have little knowledge and experience in the production of automobiles in control of the situation.

A few salient references and quotes:

"If you propose studying the development of banking, you would be wise to abandon excessively narrow categories, especially if these are based on various modern concepts, and consider banks or bankers any persons or institutions, who professionally occupy themselves with the business of payment and the circulation of credit. In this broad sense, the banking business is older than money, particularly when we exclude the various forms of commodity money, but insist on identifying money with coined metal.

"On the other hand banking-like transactions turn up in the 6th and 7th centuries BC. Older pre-monetary banking seems to have begun as deposit institutions, for temples and royal palaces used their general storage space for the most varied type of exchangeable or non-exchangeable deposits. It would often give the receiver, be it temple or palace, the right to dispose of the goods deposited as security. But it was a form of credit, and the palace or temple was obliged to return the goods on receipt with or without interest as well as principal according to the agreement.

"Moreover, even in the days of Hammurapi (1728 to 1686 BC) it was part of the normal business of the temples and royal storage buildings to make payment to third parties according to the instructions received. They could also receive and make payments to third parties according to their instructions, for example for defraying the expenses of government.

"Very early, palace and temple learned to charge for the length of time they lent out the money for paying their own and their clients' bills, and later on differences in the ever changing value of the currencies of the cities that became as numerous as the stars in heaven. The literacy required for keeping track of all that detail, the lack of bookkeeping skills, the ability to provide invoices and receipts only gradually came into existence.

"What was a novelty, however, was that near the temples and places, professional banks cropped up on a modest scale – individuals with folding tables ("bank" comes from "bench" in German or "trapezit" the corresponding word in Greek). The pioneer banker – usually with his family's support behind him – turned a profit for whatever service he could render – exchange from the currency of one city to another for each city tended to have its own coinage, breaking up the sums received from temple or palace, who had no nose for such minuscule details."

Enough of what actually happened in the pre-monetary period. Rather let's see how Washington and other governments are replacing even recognizable banking with something that retraces these pre-monetary stages.

Let us quote from *The Wall Street Journal* (16/04, "Several Groups Show Interest in GM's Saturn" by Kate Linebaugh and Sharon Teblee): "With time running out for General Motors Corp's troubled Saturn unit, the car maker said it has been approached by several groups interested in taking over the brand.

"Among the potential buyers is Black Oak Partners LLC, a private equity firm in Oklahoma City. The Group said that initially it would sell GM vehicles through Saturn's network of 440 US and Canadian dealers and later aim to add models from other makers.

"GM spokesman confirmed Wednesday that Black Oak is among the groups interested in Saturn, and that the auto maker plans to update dealers within the next week on the brand's future.

"The car maker is struggling to offload its money-losing Saturn, Hummer, and Saab brands as it faces a June 1 deadline to restructure or face a government-ordered bankruptcy."

The government, of course, is the equivalent of both the Palace and the Temple.

"A $43.4 billion US loan is keeping GM afloat as the company scrambles to slash billions in debt and overhaul operations after President Obama's auto task force shot down the company's first survival plan.

"John Pappanastos, a spokesman for the Black Oak Investor Group said it had contact with officials from the Treasury Department after it made its offer on April 4.

"Black Oak has reached out to other car maskers seeking a distribution network, such as electrical vehicle companies. Mr. Pappanastos said it has no plans to find buyers for its struggling brands."

Simply Too Early to Speculate

"GM spokesman Steve Janisse said the company is weighing several options for Saturn, including spinning off the unit to its dealers. GM, in a statement, said 'it is simply premature at this time to speculate on what any eventual outcome may be for Saturn.' Saturn, created by GM in 1985 to fend off competition from Japanese rivals such as Toyota Motor Co., has underperformed GM's already dismal companywide sales.

"In December, GM said it was evaluating Saturn's future and on Feb 17 it said it would sell or kill the brand.

"The Black Oak group said its proposal would preserve 10,000 US jobs and keep Saturn's dealer network alive.

"A spokeswoman for the group wouldn't say where the financial backing for the deal would come from or who else is involved but said such information would be disclosed in the next 5 to 10 days.

"Black Oak owns auto dealer consultancy EFG Cos. of Irving, Texas. EFG's Walkaway unit was behind the program used by Hyundai Motor Co. that allows buyers who lose their jobs to return new vehicles.

"EFG was founded by Oklahoma car dealer Bob Moore. The Bob Moore Auto Group in Oklahoma City has a Saturn franchise.

"Black Oak is also involved in auto distribution and services, oil and gas, and real estate businesses, the company said."

That makes up quite a little folding table to plant outside the Big Temple and Palace.

Bill Krehm

Dr. Obama's Odd Life-saving Emergency Ward

The patients snatched from the very jaws of death, not entirely conscious of what they have been drinking to get them into such a state. The emergency medical team test them for their chances of survival, even with the replacement of a heart here and a lung or two elsewhere. But in this marvelous hospital on the hill, eternal life and even resurrection is so much in the air, that several of them raise there heads and dispute the diagnoses of the surgeons. And the surgeons themselves modestly accepting that as a sign of the magic from their having laid hands on these remarkable wrecks that had been believed at death's door, obediently take dictation from the patient of what the proper diagnosis should be.

If you think I might be kidding, I refer you to *The Wall Street Journal* (09/9, "Banks Won Concessions on Tests" by David Enrich, Dan Fitzpatrick and Marshall Eckblad): "The Federal Reserve at the last minute significantly scaled back the size of the capital hole facing some of the nation's biggest banks, following days of intense bargaining over the stringency of the stress tests.

"In addition, according to bank and government officials, the Fed used a different measurement of banks' capital levels than analysts and investors had been expecting, resulting in much smaller deficits.

"Even though the overall reaction to the stress tests is generally positive, the haggling between the government and the banks shows the sometimes-tense nature of the negotiations that occurred before the final results were announced Thursday.

"Over the next two weeks, at least half of the banks pushed back, according to people with direct knowledge of the process. Some argued the Fed was underestimating the banks' ability to cover anticipated losses with revenue growth and aggressive cost-cutting. Others urged regulators to give them more credit for pending transactions that would thicken their capital cushions.

"At times, frustrations boiled over. Negotiations with Wells Fargo, where Chairman Richard Kovacevich had publicly derided the tests as 'asinine,' were particularly heated, according to people familiar with the matter. Government officials worried San Francisco-based Wells might file a lawsuit contesting the Fed's findings.

"The Fed ultimately accepted some of the banks' pleas. Wells Fargo's capital hole shrank to $13.7 billion, according to a federal document.

"At Fifth Third the Fed was preparing to tell the Cincinnati-based bank to find $2.6 billion in capital, but the final tally dropped to $1.1 billion. Fifth Third said the decline stemmed in part from regulators giving it credit for selling a part of a business line.

"Citigroup's capital shortfall was initially pegged at roughly $35 billion, according to people familiar with the matter. The ultimate number was $5.5 billion. Executives persuaded the Fed to include the future capital-boosting impacts of pending transactions.

"The Fed's findings were less severe than some experts had been bracing for. A week-long rally in bank stocks continued Friday with KBW Bank Stocks Index surging 10%. Investors were especially relieved by the relatively small capital holes at regional banks. Shares of Fifth Third Bancorp, which faces a $1.1 billion capital hole, soared 59%, while Regions Financial Corp.'s $2.5 billion deficit to a 25% leap in the stock."

In this marvelous surgery on the hill, it seems when a questionable diagnose was made, it itself at times brought on a cure. Hold your seats, just in case a new religion emerges from such reverse miracles as are recorded in *WSJ*.

"With the stress tests, government officials were walking a fine line. If the regulators were too tough on banks, they risked angering their constituents and spooking markets. But if they were too soft, the tests could have lost credibility.

"All the back-and-forth is typical of the way regulators traditionally wrap up their examinations of banks. Regulators often present preliminary findings to lenders and then give them time to respond. On Friday, some analysts said that the government may have bent too far in the direction of the stress-tested banks, especially on the yardstick chosen by regulators to assess capital levels.

"According to Gerard Cassidy, an analyst with RBC Capital Markets, the 19 banks' cumulative shortfall would have been more than $68 billion deeper if the government had used a capital metric that accounted for unrealized losses. 'That would have changed the whole tone of the report,' he said. This is the real flaw in the stress tests.

"Government officials defended the way they handled the stress tests and said their projections reflected the most comprehensive analysis ever conducted of the industry.

"The test results showed that the 19 banks faced a total of $599 billion in losses over the next two years under the government's worst-case, Depression-like scenario. The Fed directed 10 banks to add a total of nearly $75 billion to their capital buffers to insulate themselves from potential losses.

"Banks pressed ahead on Friday with plans to fill their capital holes by tapping public markets. Wells Fargo raised $7.5 billion in stock through a public offering. The bank originally planned to raise $6 billion, but expanded the offering, which was valued at $22 per share, due to robust demand. Shares of Wells Fargo rallied $3.42. or 14%, to $28.20.

"Fed officials expected the tests to encounter criticism, including of the metric the government was using to gauge banks' capital levels. Indeed, some analysts are questioning the Fed's use of a capital yardstick known as Tier 1 common equity. Many experts had assumed the Fed would use as better-known metric known as 'tangible common equity.'

"People will argue that's why the stress test results look so good, because [regulators] came up with an alternative measure of capital adequacy that led to a higher ratio,' said Robert Willens, president of tax and accounting advisory firm Robert Willens LLC in New York."

If we may pick up my comparison at the beginning of this reflection, the white-coated surgeons who were overridden in their diagnosis and proposed surgery by the patients lying at death's very door, it seems that they too, were up to their elbows in distorting the diagnosis and therapy, even before the patients lying seemingly helpless on the operating tables, had begun simplifying the diagnosis and the cure.

William Krehm

Is London Bridge Down?

What middle-aged Canadian does not remember the name of Paul Reichmann, who designed, built and eventually lost some of Toronto's best designed office-buildings? What may have contributed to his Canadian disasters was that he got involved in doing even more dashing pioneer development to relieve the congestion in the City of London, allegedly because Margaret Thatcher had agreed to have rapid transport built from the City of London where the old brimming business center stood to the former wharves in East London become too small for modern ships. The story went that Maggie Thatcher didn't keep her promise and as a result the transport to the new development in East London was slow in attracting business tenants.

But there seems to have been more at stake than that, because the bad luck has caught up to the Reichmann's East London buildings, too, a couple of decades later.

At this point we will turn over our tale to Eric Reguly and his story in *The Globe and Mail* (21/03, "London Falling"): "The heart of Britain's tallest buildings, One Canada Square, is no longer the international bolt hole of Bear Stearns with its 1,370 employees. The Wall St. firm collapsed last spring. A short stroll will take you to the defunct London offices of Lehman Bros., which had covered one million square feet before the firm went bankrupt in September. Citibank, propped up by endless US government bail-out loans, is still a Canary Wharf tenant, but a vastly diminished one as it eliminates tens of thousand employees around the world.

"[According to the] running tally done by the financial website Here is the City the figure is shocking: between August, 2007, and February, 2009 133,000 jobs were lost in investment banking, private banking, and asset management. Topping the list of woe is the new owner of Merrill Lynch, with 29,260 jobs vaporized at the two companies. As the downturn in the global financial services industry becomes dire, the futures of other big Canary Wharf names – Barclays, Morgan Stanley, Credit Suisse, HSBC – at Europe's premier office development remain uncertain.

"London parties like no other city in Europe during the boom years, which began in the mid-1990s and were driven by the massive influx of capital investment capital and jobs into investment banking, asset management, underwriting, private equity and derivatives markets.

"Throw in one of the hottest real estate markets on the planet and you had a recipe for extraordinary growth.

"Now, London is falling as quickly as it rose. And there is little doubt that things will get worse before they get better, for London is the victim of a rare double-bubble: real estate and financial services.

"The recession is still deepening, and some of its effects have yet to be felt. As the City contracts spin-off jobs are in jeopardy too. But businesses such as restaurants and fashion stores often try to tough it out for months, perhaps a year, before giving up.

"The news isn't entirely grim. Indeed, the first signs of London's potential resurrection are already visible.

"Nomura has commandeered the old Lehman space. Not far to the east, an entirely new metropolis – Stratford City – is under construction next to the 2012 London summer Olympics site. Driven by discounting and reduction in the value-added tax (akin to Canada's GST), retail sales in London rose 6.5% in January, compared with 1.8% nationally, and the weaker pound is keeping the tourists armies on the march.

"The job loss figure of 133,000 tallied by Here is the City does not include spin-off jobs in everything from law firms and ad agencies to accountancies and print shops. You can assume that these industries have entered the house of pain too. That's because business services, which account for 25% of the London economy are 'very dependent' on the 8% of the economy directly linked to the financial services, said Mayor Boris Johnson's economic director, Anthony Browne. A recent report he co-authored noted that the London consumer services have yet to return to 1970s levels, while manufacturing employment is down 80% from 40 years ago.

"British Airways killed flights between Dublin, another bombed-out financial center and the City of London airport near Canary Wharf because the drop-off in demand.

"The German bombs of the Second World War and postwar deindustrialization turned East London into something of a wasteland, but one with huge development potential because of the vast amounts of land close to the heart one of the world's great cities.

"'We worry about how deep the recession will get;' Mr. Browne said. 'We're on a journey to the unknown.'"

W.K.

The Guilty Parties Themselves are Starting to Ask Pernickety Questions

For example, *The New York Times* (09/03, "Questions Over Bailout For Insurers" by Mary Williams Walsh) reels off this one: "As the Treasury Department considers life insurers' applications for a bailout, big questions remain about how hard a bargain the government will drive.

"The Treasury has taken two different stances in its six months running the Troubled Asset Relief Program or TARP. For the banks, cash infusions came quickly, with few strings attached, in an urgent attempt to strengthen the financial system.

"But after initially extending credit to the automakers, the Treasury has taken a much harder line with Detroit by insisting that General Motors produce a more credible business plan and Chrysler seek a merger partner.

"The question is whether the Treasury will pour billions more into shoring up the life insurers or subject each to rigorous testing, then determine which are viable and perhaps enforce quiet mergers and divestitures for those too weak to save….

"But the stock market seemed to believe that the insurers' chances were greatly improved on Wednesday…. All of the dozen insurers that have applied for TARP money are believed to be life insurers, although not all have been identified. Some are well-known companies like Metlife and Prudential Financial….

"Insurance companies are acutely vulnerable to rating downgrades – once an insurer falls below AA status, it can start having trouble getting new business. Many life insurers have already suffered credit downgrades this year because of losses in 2008. And with markets still weak as of March 31 – the day insurers generally marked their assets to market for their first quarters – investors worry that more downgrades are coming.

"Infusions from TARP could offset that pain by restoring some capital, if the Treasury acts in time.

"The life insurers have been waiting for nearly half a year, after being told last November that they could apply for TARP money if they had a federally regulated affiliate. Several insurance companies promptly bought thrift institutions to obtain their federal charters.

"While the applicants have waited, all have grown weaker.

"'We think that the life insurance industry is in a very precarious position,' analysts for Bridgewater Associates, a hedge fund, said in a report last month. 'It does not appear that some of the large insurance companies are in a position to weather the storm.'

"Concerning state regulators overseeing the insurance industry, they wrote: 'There is a lot of stalling and hope that someone else will deal with the problem. This may be all that can be done until someone in Washington decides insurance companies are systemically important.'

"The Treasury secretary, Timothy F. Geithner, has said that reining in systemic risk is a priority, but has not offered specific proposals or definitions.

"Late last year, life insurance officials said they, too, should qualify for federal money, citing their huge presence in the bond markets, then under extreme duress.

"The government seemed to agree that they might pose a form of systemic risk. The life insurance industry now hold about 18% of all United States corporate bonds, as well as big blocks of commercial mortgages and government bonds.

"If an insurer should get into financial trouble, its policyholders would presumably be protected by the guarantee fund of its home state. But if a big, troubled insurer were caught in a cash squeeze and began selling off bonds to raise cash, the insurers argue that it could wreak further havoc on the bond markets.

"The Bridgewater analysts said the life insurers would also have liquidity problems in a period of high unemployment. When unemployment rises and consumer credit dries up, people may surrender their life insurance policies or borrow against their cash value.

"Bridgewater projected that life insurers could run through $500 billion during the next couple of months to meet policyholder demands…. But it is not clear that this amounts to the sort of systemic risk that the Treasury wants to contain.

"Another problem is the use of derivatives – specifically, the credit-default-swaps that nearly toppled American International Group last fall. They are used routinely for various purposes by large insurance companies, without incident. But if a weakened insurer had swaps that required it to come up with a lot of collateral suddenly – as happened with AIG – that could produce the kind of risk in the financial system that the Treasury views as unacceptable."

That is enough to put a question mark over the liquidity of the US government itself since it has chosen to finance its needs through the private banks that are no longer restricted by the *Glass-Steagall* legislation that banned the banks from acquiring interests in the other non-banking financial pillars – to wit, stock brokerage, insurance and mortgage companies. There was good enough reason for that law – the reader will note had it effectively been in force, there could have been no stock market super-boom and super-bust, and no subprime mortgage bust, and our insurance companies would be in a position to insure whatever is insurable.

For our readers will grasp that not everything is insurable. For example the proposition 2 + 2 = 5. That is not just *risky,* it is *wrong.* Unfortunately the shift of economic theory from something based on the human effort that goes into the creation of a product to entirely the personal satisfaction of the ultimate consumer – supposedly "scientific" because it makes use of the infinitesimal calculus draws the attention of economists and governments away from the real value of society's products.

Marginal utility theory explains economic value by the enjoyment that the last unit may have given the consumer – a purely subjective item. That distracted attention from what was going on in the factories under the raw industrialism of the day. With a working class that had become literate it was seen as a major risk to bandy about labor theories of value, that in one form or another, related the value of the product to the amount of "average labour" that went into its production. Or a cost of production theory that still centered on what went on in the work shops. At a time when barricades were being thrown up in almost every capital of Europe, it was seen as incendiary to attribute the value of a product to anything stemming from those unregulated primitive factories, especially since the recently illiterate factory workers were learning to read.

Economists' Mathematical Superstition

There is, moreover, a deep superstition that persists amongst economists to this day about infinitesimal calculus holding the scientific solution to just about any problem. In fact the *empirical* contribution that mathematics can bring to any problem is exactly zero. It is its powers of *analysis* that are unlimited.

Yet as keen a socialist as George Bernard Shaw missed the point and espoused marginal utility as the crack of the whip of science in its purest form.

Over the past several years I must have attended at least a dozen academic conferences at which any serious discussion of derivatives was simply not permitted. What was never mentioned was the exponential infinite series where the rate of growth keeps pace with the value of the expression already attained is in fact the mathematics underlying the atomic bomb.[1]

"Property and casualty insurers are generally less leveraged and are therefore considered less vulnerable to financial shocks, though their outlooks have deteriorated, as reflected in the credit downgrade of Berkshire Hathaway. None of them has applied for federal assistance.

"Insurance companies…are acutely vulnerable to ratings downgrades – once an insurer falls below AA status, it can start having trouble getting new business…. And with the markets still weak as of March 31 – the day insurers generally marked their assets to market for their first quarters – investors worried that more downgrades are looming.

"Late last year, life insurance officials said they, too, should qualify for federal money, citing their huge presence in the bond market, then under duress.

"If an insurer were to get into financial trouble, its policyholders would presumably be protected by the guarantee fund of the home state. But if a big, troubled insurer were caught in a cash squeeze and began selling bonds to raise cash, the insurers argue that it could wreak further havoc on the bond markets.

"Another problem is the use of derivatives – specifically, the credit-default swaps that toppled American International Group last fall. They are used routinely for various purposes by large insurance companies, without incident. But if a weakened insurer had swaps that required it to come up with a lot of collateral suddenly – as happened to AIG – that could produce the kind of risk to the financial system that the Treasury regards as unacceptable."

In short it is high time for economists to catch up with all the discussion of derivatives that has been discouraged at most academic conferences for the past decade.

William Krehm

1. The exponential series on which derivatives are based starts out with 1 then X then X squared and goes on to an infinite number of terms. The rate of growth of the first term is 0 since 1 doesn't grow. Not to worry: the second term X grows as fast as it grows and hence becomes "1" and if we stick to just the variable portion of the expression there is always an additional term at the infinitely distant other end – there is in fact no end – that may by now be in Europe or China if we were to stick to just the variables in each term. The trouble is that the constant coordinates that move up on the scale with the denominator coming from derivation build up faster than the numerators resulting from the successive higher degrees of derivations. So this is outstripped by the constant of integration that builds up in the numerator. That is of key importance in the designing of the atom bomb, since in any equation – starting with a linear one it is the constant coordinates that determined the direction of the total effect. Thus $x + y = 2$ will intersect $x - y = 3$. Transferring this to our exponential equation this will result in the atomic bomb changing the direction of its passage, and may have ended up in Vladivostok or wherever rather than in Hiroshima. Applying derivatives to the figures of economic growths without this keen sense of the coordinates in constant terms, was bound to result in surprising disasters. The world is enjoying them at the moment. But since the whole subject of derivatives has never been more than gingerly discussed, our progress in avoiding these disastrous consequences has been modest.

Rating Agencies Need Reform

Diane Francis writes in the *Financial Post* (28/04): "Credit-rating agencies contributed to the current economic collapse. They were paid fees by banks who sometimes pressured or shopped around for the most favorable risk assessments, an obvious conflict of interest. Despite the culpability, nothing much has been done about these intermediaries. The credit-rating issue has been mostly ignored by the G20, politicians and regulators. Reforms are still being debated even though they should have been implemented long ago.

"Business leaders are being perplexed about this vacuum of accountability, and two were outspoken about this issue at a recent World Economic Forum conference in Rio de Janeiro.

"'The problem we had was the rating agencies like Moody's had been paid by the banks to rate these pieces of paper and the banks let it be known they would shop around until they got the right rating,' said Jim Goodnight, founder and CEO of SAS, a leading business analytics software provider.

"Lord Levene, chairman of insurance giant Lloyds of London said, 'Enron was rated Triple A just weeks before it went bust, so why didn't we learn from that and do something?'

"Their business model was strange: if you have a target rated, who pays for the rating? The target does. That's a conflict of interest, and I'm surprised the G20 didn't deal with that.'

"Perhaps nothing has been done because the same regulators who missed the Enron and tech bubbles missed this credit bubble. Perhaps nothing was done because of the inordinate political and media clout (and co-ownership) enjoyed by credit-rating agencies such as Moody's, Standard & Poor's and others.

"Since the nightmare began in August, 2007, with poorly rated asset-backed paper, Washington has been looking at the inherent conflicts and other malpractices among these agencies.

"Credit-rating agencies should be standalong businesses where their only business would be to produce credible and reliable ratings. They should be financed by a translation fee, not advice fee.

"Governments should support competing rating organizations and require two or more opinions. on ratings so that there is competition beyond the two main players, Moody's and Standard & Poor's.

"The Association has 16,000 members who manage and safeguard the financial assets of more than 5,000 US organizations. Its spokesman, Jim Kaitz, testified in Washington this month.

"'The current rating agency processes and business model are broken,' he said. 'The big two rating agencies were a catalyst for the sub-prime debacle and resulting meltdown. The time has come for a fundamental overhaul of the system to restore investor confidence and re-establish efficient global capital markets.'

"Despite evidence and pressure, the SEC said last week that new regulations could take months to put in place, even though the agencies issued top ratings for investments – notably subprime junk – that have plummeted in value. Fixing these intermediaries is essential to avoid future crises."

As Eagles Preparing to Swoop Down on Their Prey

The New York Times (05/06, "As Investors Circle Ailing Banks" by Eric Lipton) informs us: "Cainsville, MO – No one seems to want to own a business in this dusty, windswept corner of rural America, population 370, with its crumbling sidewalks and boarded-up storefronts.

"Except, that is, for J. Christopher Flowers, a media-shy New York billionaire who last year bought First National Bank of Cainsville, on of the US's smallest national banks.

"Mr. Flowers, a private equity manager, has no particular love for rural Missouri; in fact, he has never set foot in Cainsville. Rather, he wants to use the national bank charter he picked up in this farm town to go on a nationwide buying spree.

"With this charter in hand, Mr. Flowers plans to take over a handful of large struggling banks, casualties of the economic crisis. In some cases, he hopes, the federal government will help.

"But Mr. Flowers, whose investments in banks overseas have made him one of the richest men in America, has run into a major obstacle in the US: the Federal Reserve, and its very notion of what a bank should be.

"The Fed does not mind if private equity firms have a minority interest in banks – the Obama administration even wants them to invest. But the Fed will not let them take control, a stance the firms are lobbying regulators mightily to change, especially given that stress test results to be released Thursday are expected to show a glaring need for capital in the banking system,

"It's not personal, Fed officials say. It's just that as the nation recovers from one of the worst banking crises in history, the Federal Reserve wants to make sure that it does not set the stage for the next financial implosion by turning banks over to private equity firms, some of the riskiest players in the business world.

"So while Mr. Flowers was able to buy the bank here with his own money, he cannot tap into the billions his firm, J.C. Flowers & Co., has raised.

"How this battle – and others being fought in the aftermath of the economic crisis – plays out will help determine the future shape of the financial industry.

"For all the talk of the banking crisis, Mr. Flowers and other giant private equity giants are circling distressed banks around the country, competing to buy into the industry. Bidding wars are now breaking out among private equity firms, including the Carlyle Group, which is going up against Mr. Flowers's firm for a stake in Bank United of Florida."

The Recession's Greatest Prize

"They and other investors see banks as the recession's biggest prize: potential money machines that could one day generate fabulous returns, particularly after the federal government eats the losses of failed banks, then heavily subsidizes their sale. But like Mr. Flowers, some of them would prefer to take over the banks completely, replace their managements and take all the profit.

"'I don't think the Republic is going to be brought to its knees if private equity owns banks, personally,' Mr. Flowers said from his Midtown Manhattan office with its expansive views of Central Park. 'We invest around the world – Japan, Germany England, no problem.'

"The Fed is resisting this pitch, for several reasons. Current law prohibits mixing banking and commerce, based on a fear that if industrialists own banks, they will dominate – and try to manipulate – the economy, as they did during the early 20th century heyday of John Pierpont Morgan.

"The government also wants the ability to stabilize a teetering bank by drawing on the funds of the parent company. That is hard to do with private equity firms, which have numerous businesses owned by firms, each of which is walled off to protect investors.

"For these reasons, banks generally cannot be owned by non-financial companies like the Carlyle Group, whose assets are as varied as an interest as an interest in Dunkin' Donuts and United Defense industries, a maker of combat vehicles and missile launchers.

"The equity firms counter that banking desperately needs cash if the economy is going to recover, and that they are the only big sources of money around. An executive at the Carlyle Group said the industry had an estimated $400 billion ready-to-invest reserves.

"To push their case at the White House, the Treasury and the Fed, Mr. Flowers and others in his industry have enlisted an all-star cast of advisers, lobbyists, and lawyers. Part of their strategy, Mr. Flowers said, is to persuade the Treasury secretary, Timothy F. Geithner, to pressure the Fed to 'back down.' While they press their case, the firms have found some ways around the rules.

"They have formed so-called club deals, in which teams of private equity firms have found some ways around the rules.

"They have formed so-called club deals, in which teams of private equity firms and other investors each buy up to the legal limit of a bank – about a quarter or a third, depending on the type of a bank – with their individual pieces adding up to 100% control. IndyMac, the failed California bank, was sold by the Federal Deposit Insurance Corporation to one such club ; the hedge fund billionaires George Soros and John Paulson; and Michael S. Dell, founder of the Dell commuter company. The investors are barred from acting in concert in concert to, in effect, take control of the bank – an unwieldy arrangement but one that regulators insist they can enforce. Mr. Flowers has come up with another way around the restrictions. There is no limit on an individual's taking over a bank, so he purchased all of the First National Bank of Cainsville in his own name and with his own funds. But that deprives him of the billions his equity firm has set aside to buy banks, so his new bank sits in this town, waiting for a change in the rules.

"First National – whose second storey is boarded up and whose $17 million in assets are worth about a third of what Mr. Flowers paid for an Upper east Side town house in 2006 – seems an unlikely launching pad for a new American banking empire.

"The town is so tradition-minded that it refused to change the spelling of its name, even after the town did so back in 1925 to honor its founder, Peter Cain.

"Suddenly, in February, the First National Bank name was dropped and 'Flowers Bank' was painted on the window. New bank executives showed up, passing out packs of promotional sunflower seeds with the bank's new logo, urging the mostly elderly tows residents to get ready to 'Grow with Us.'

"Everyone wonders, who is this Flowers guy?, said Lefty McLain, as he finished up the ham, mashed potatoes and butter beans lunch special, an all-in-on restaurant, deli, pool hall and gossip post here in the one-block downtown.

"Mr. Flowers, while still in his twenties, founded Goldman Sachs's financial services merger business, helping line up the $62 billion merger of NationsBank and BankAmerica (now Bank of America), and the $34 billion takeover of Wells Fargo by Norwest.

"Mr. Flowers, in an interview, said he was confident he would prevail. He has estimated his banking empire will one day return at least a 35% return on banks he has bought in the US. "I find it an extraordinary time to invest," he said.

"He was even more blunt when he spoke to an industry group in New York earlier this year. 'Low-life grave dancers like me will make a fortune,' he predicted."

W.K.

The CANSEC War Fair: Weapons Galore and Global Warfare

Canada's top war industries have their sights set on Ottawa and are aiming to exhibit their wares at CANSEC 2009, Canada's largest military arms bazaar, at Lansdowne Park, May 27-28.

More than 50 of these Canadian military export industries are linked to the production of weapons systems that most people in this country probably recognize as morally reprehensible and thoroughly unCanadian, if not downright illegal.

Among the all-Canadian weapons exported by CANSEC 2009 exhibitors are:

• Anti-personnel cluster bombs, fragmentation bombs and phosphorous bombs

• Automatic weapons, semi-automatic weapons, machine guns and chain guns

A new online report (http://coat.ncf.ca/ARMX/cansec/topCANSEC.htm) by the Coalition to Oppose the Arms Trade (COAT) reveals that CANSEC exhibitors are also engaged in the manufacture of essential high-tech components embedded in weapons systems that deliver the following:

• Nuclear weapons
• Depleted uranium munitions
• Anti-personnel cluster bombs
• Anti-personnel landmines

These particularly inhumane munitions – widely regarded around the world as illegal – are "delivered" to their targets by a variety of war planes, cruise missiles and land-based systems that contain significant quantities of Canadian components. COAT's online report provides details about dozens of these weapons "delivery" systems and reveals hundreds of online sources of information documenting Canadian corporate complicity in their manufacture. Most of these weapons systems, complete with Canadian hardware, have been used in the Iraq War which has so far claimed the lives of more than 1.3 million people, mostly innocent civilians, since 2003.

CANSEC exhibitors also include about a dozen Canadian companies engaged in the design, creation, development and/or production of: "ballistic missile defense" (BMD) weapons systems.

Many Canadians would be surprised to learn these facts because they contradict commonly-held mythologies about this country.

Preaching Peace, Profiting from War

COAT's research into CANSEC 2009 exhibitors demonstrates that Canada's military exporters are continuing their long-standing tradition of aided and abetted not only US and NATO preparations for waging nuclear war and the ongoing use of anti-personnel landmines, but also the research and development of BMD weapons and the production of components for dozens of major weapons systems used in the Iraq War.

This, of course, is completely at odds with many official "feel-good" Canadian government pronouncements supporting world peace and opposing nuclear weapons, landmines, BMD and the Iraq War. However, many of the Canadian war industries exhibiting at CANSEC 2009 have received government funds, subsidies and "investments" to support their specific work to develop and produce these weapons-related systems.

So, although Canada's prevailing cultural mythology presents this nation as one which supports peace keeping and peace building, CANSEC 2009 (and its corporate and government participants) graphically symbolizes this country's actual commitment to war, and the ongoing enterprise of profiteering from the use of numerous immoral, reprehensible and illegal weapons systems.

The local level of government is also involved. In 1989, the City of Ottawa passed a binding Motion banning all arms shows from municipal property (http://coat.ncf.ca/ARMX/bylaw.htm). Now, however, arming themselves with a legal technicality, staff at the City of Ottawa have bypassed the elected Council and booked CANSEC 2009 for Lansdowne Park, the municipality's prime, publicly-funded facility.

If you are in Ottawa, please join us in getting more petitions (http://prax.ca/coat/No-Arms-Shows) signed and in contacting Ottawa's City Councillors. Also, please join us on May 27 (http://coat.ncf.ca/ARMX/cansec/CANSEC-rally.htm) for speakers, music and a candlelight peace vigil.

A growing public movement led by peace, environment and social justice activists across Canada are now challenging CANSEC. If you haven't already done so, please sign COAT's online petition and encourage others to likewise. We need and appreciate your support (http://coat.ncf.ca/support_us/donation.html) and assistance. All donations to COAT over $25 will receive a subscription to our magazine, Press for Conversion! Thanks.

The CANSEC War Fair, Weapons and Warfare

The links between CANSEC 2009 exhibitors and their exports of weapons, and weapons-system components, provide us with many sound reasons for opposing this blatant manifestation of the international trade in war technology. For instance:

Fuelling the Iraq and Afghan Wars

Coalition to Oppose the Arms Trade (COAT) research reveals that at least 50 Canadian arms exporters attending CANSEC have supplied products for three dozen major weapons systems used in the current Iraq War. These include the main warplanes, cruise missiles, drones, tanks and large artillery/cannons used to wage this illegal war which Canadians overwhelmingly oppose. Most of these US weapons, complete with Canadian parts, have also been used to great effect in Afghanistan.

Nuclear Bombs and Missiles

CANSEC exhibitors also include Canadian military exporters that supply high-tech components for "weapons delivery systems" currently tasked to wage nuclear war, namely, B-52 bombers, "Tomahawk" sea-launched cruise missiles and the stealth B-2 "Spirit," which costs more per plane than an annual Ottawa City budget!

Depleted Uranium Munitions

COAT's research also reveals 20 CANSEC exhibitors that help manufacture seven varieties of "delivery systems" that have fired more than 1,000 tons of highly-toxic, radioactive Depleted Uranium (DU) munitions in Yugoslavia, Afghanistan and Iraq. DU dust will continue to unleash environmental destruction, cancers, leukaemias and other horrendous health effects upon innocent children and others for generations to come.

"Ballistic Missile Defense" (BMD) weapons

A dozen Canadian war industries now heading for Ottawa's CANSEC arms bazaar, have played significant roles in the research, design, development, testing and production of so-called BMD weapons. The primary purpose for these cutting-edge systems, as revealed by Pentagon documents, is not to defend the "Homeland" (as publicly claimed) but to protect US forces and their weapons abroad during battles in faraway war zones. "Homeland defense" is merely the pretext used to garner needed public financing for multi-billion dollar BMD weapons programs.

Small Arms and Ammunition

CANSEC will also host Canadian companies that produce "small arms" and ammunition that is now being used by US and other NATO warfighters in Iraq, Afghanistan and elsewhere. Colt Canada, which makes automatic and semi-automatic weapons, chain guns and other machine guns, is now soliciting photos for a contest highlighting its weapons in Iraq and Afghanistan.

Each year, a Montreal branch plant (OTS) of US war behemoth, General Dynamics, exports millions of rounds of ammunition to the US for use in Iraq. It too will be seeking additional export contracts during its presence at CANSEC this May.

Anti-personnel Cluster Bombs, Fragmentation Bombs and White Phosphorous

Winnipeg's Bristol Aerospace, which started thanks to Canadian government grants, is now world famous for making unguided, air-to-ground missiles. Some of Bristol's Canadian-made CRV-7 warheads include antipersonnel cluster bombs with submunitions that "optimize fragment size against personnel...." When another variety of Bristol's CRV-7 warhead explodes, "thousands of small, high velocity fragments" spray out to kill people. It too is designed for antipersonnel applications (www.magellan.aero/content/objects/CRV7_Rotary_Wing.pdf). Another of these Canadian warheads uses a mixture of "high-explosive" and "white phosphorous," a chemical that can burn through skin and flesh down to bone (www.magellan.aero/content/objects/CRV7_Rotary_Wing.pdf).

Anti-personnel Landmines

Canada led the way on a global treaty to ban anti-personnel landmines. The signing of this global convention took place in Ottawa and has subsequently been called "The Ottawa Treaty." However, this will not hinder dozens of Canadian military companies exporting products for US warplanes that deliver "anti-personnel landmines" to their human targets. Thirty five of these companies identified in COAT's report will be exhibiting their wares in Ottawa at CANSEC 2009.

Who Pays the Price?

War fair organizers, weapons manufacturers, and others beholden to their narrow vested corporate interests, often proclaim that military trade shows are a boon to profits and business. However, those supporting general public health, safety, welfare, democracy and peace, and those concerned with broader concerns for environmental protection, challenge the contention that fuelling war serves the public good or the preservation of ecosystems.

We ask what expense to the environment, to democracy and to human lives does this trade in war technology continue? Who pays the price when military hardware and weapons are proliferated around the world and used in global wars? Special interest groups, like weapons manufacturers and their PR advocates in government and media, should not be allowed to over rule widespread public interest which overwhelming supports peace, not war.

Twenty years ago, the elected representatives of Ottawa citizens voted 11 to 1 to ban all military trade shows from municipal property. The concerns they so eloquently expressed about the international trade in military technologies are as valid today as they were then.

Let's stop CANSEC and other Canadian arms shows, for good!

Richard Sanders
Coordinator, Coalition to
Oppose the Arms Trade

For more details on CANSEC and how to get involved in the campaign to expose and oppose it, please visit COAT's website: http://COAT.ncf.ca.

To see the COAT detailed report described in this article, which lists the names of companies, and what they are supplying for dozens of weapons systems, go to http://coat.ncf.ca/ARMX/cansec/topCANSEC.htm.

Could Somebody Up High be Trying to Teach Us Some Key Lessons?

First came the decades of Globalization and Deregulation that has kept the planet bristling with ever more deadly armament and bleeding with civil and interracial wars. And now amidst a collapsing world economy comes the deepening problems between some key universities and their lay neighbors.

The New York Times (05/9, "Across US, Slump Revives Town-Gown Divide" by Abby Goodnough) makes you shudder with embarrassment for the churlish behavior into which our society is sinking.

"Boston – The rats are out in spades this spring in North Allston, a gritty neighborhood wedged between the Charles River and the Massachusetts Turnpike, and residents are blaming Harvard.

"Harvard had big plans to expand its campus into Allston with a science complex. But last winter, the university announced that the recession would force it to slow – perhaps even halt – the $1 billion project. Now Allston residents are living with a gaping hole and a bunch of vacant buildings instead of the prospect of a revitalized neighborhood.

"They are not alone feeling burned by a university. As endowments everywhere sink with the economy, town-gown relationships, often carefully nurtured during the boom years as colleges and universities sought to expand, are fraying.

"'We feel like we have been betrayed and taken advantage of,' said Harry Mattison, a resident who serves on the Harvard Allston Task Force, an advisory group. Instead of Harvard bringing in jobs and excitement and vibrancy, we are sliding backwards.

"Some cities and towns – including Ann Arbor, Mich., Durham, NC, and Princeton, NJ – have renewed calls for local colleges and universities to make voluntary payments to the communities because they have tax-exempt status at the expense of property taxpayers.

"Response from the institutions has been frosty.

"'The recession will certainly keep private colleges in the crosshairs of policy makers looking to expand the tax base,' said David L. Warren, president of the National Association of Independent Colleges and Universities. 'However it will be challenging that an institution that has lost 20 to 30 percent of endowment value in the past six months, and is cutting millions from its budget, is overflowing with excess revenue.' In Boston, which already gets about $59 million a year in voluntary payments from 13 colleges and universities, Mayor Thomas M. Menino has asked a task force to study how to wring more revenue out of the institutions.

"In Worcester, Mass., one elected official has gone so far as to propose a tax on dorm rooms, and idea that is gathering support as layoffs take place.

"Resentment runs especially deep in Allston, which had finally been warming to Harvard's expansion plan after years of opposition. In addition to the construction pit – a five-acre foundation for the complex – a string of vacant buildings that Harvard bought over the years but failed to lease have left the residents fuming."

How a Science Centre Becomes a Hole in the Ground

"Harvard will finish building the foundation for the science complex in the coming months and then decide whether it can afford to continue, said Christine Heeman, the university's vice-president for government, community and public affairs.

"Harvard even forced some tenants like a Volkswagen dealership out of buildings for which plans are now not clear.

"Others have proposed levying taxes on dorm rooms, an idea that is gathering support as layoffs take place.

"Resentment runs especially deep in Allston, which had finally been warming to Harvard's expansion plan after years of opposition. In addition to the construction pit – a five-acre foundation for the complex – a string of vacant building bought over the last 20 years but has failed to lease have also left residents fuming.

"Harvard will finish building the foundation of the science complex in the coming months and then decide whether it can afford to continue. A halt in construction would require covering the 40-foot-deep foundation and addressing other 'aesthetic or safety concerns.'

"Harvard has continued smaller projects in Allston, like planting trees and starting a weekly farmer's market. But the scientists who were supposed to move into the new complex in 2011 will work elsewhere indefinitely."

Could the heavens be gently reminding the most distinguished universities that had they really pondered the significance of their "university" they would have considered that it meant considering all main current of thought, and of all the major teaching that can be derived from our history. Had it done that, it would have come up with a positive solution for what is causing it, and their students so much embarrassment, both financial and moral.

There are important lessons that had been learned at no small cost with a direct bearing on the deepening embarrassments around funding and moral stances. Let me summarize just a few:

1. At the end of WWII Washington sent hundreds upon hundreds of young economists to Japan and Germany to study the damage inflicted during the war. Their mission was to predict how long it would be before those two great defeated powers could recover enough to become formidable traders on world markets once again.

In 1961 one of these, Theodore Schultz of the University of Chicago, wrote a paper in which stated it was remarkable how far he and his colleagues had missed the mark. This he attributed to their having concentrated on the physical destruction and attributed little importance to the fact that their human capital – their highly trained, and disciplined work force – had come out of the struggle essentially intact. From this he concluded that investment in human capital – education and hence, too, health and the environment – are the most productive investments a government can make.

Undoubtedly, it was one of the greatest lessons that came out of WWII. Schultz for a very few years was feted and decorated, but soon completely forgotten along with his great concept. Yet that great lesson has only gained in importance today in providing a way out of the current economic meltdown. Yet it is hurting and further demeaning our universities.

Schultz and his great discovery were unacceptable to those in political control

Globalization was Touted to Unite Rather Than to Divide

Globalization was presented to the world as the final comprehensive bundle of promise, that like the prophets of old would unite rather than divide. How different the result than the prospectus! *The New York Times* (23/04, "Goodbye, Honored Guest" by Hirocho Tabuchi).

"Hamamatsu, Japan – Rita Yamaoka, a mother of three who immigrated from Brazil, lost her factory job here. Now, Japan has made her an offer that she may not be able to refuse.

"The government will pay thousands of dollars to fly Mrs. Yamaoka; her husband who is a Brazilian citizen of Japanese descent; and their family back to Brazil. But in exchange, Mrs. Yamaoka and her husband must agree never to seek work in Japan again.

"'I feel immense stress. I've been crying very often,' Mrs. Yamaoka said after a meeting where local officials detailed the offer in this industrial town in central Japan.

"I tell my husband we should take the money and go back,' she said, her eyes teary. 'We can't afford to stay here much longer.'

"Japan's offer, extended to hundreds of thousands of blue-collar Latin American immigrants, is part of a new drive to encourage them to leave this recession-wracked country. So far at least 100 workers and their families have agreed to leave, Japanese officials said.

"But critics denounce the programs as short-sighted, inhumane and a threat to what little progress Japan has made in opening its economy to foreign workers.

"'It's a disgrace. It's cold-hearted,' said Hidenori Sakanaka, director of the Japan Immigration Policy Institute, an independent research organization.

"'And Japan is kicking itself in the foot,' he added. 'We might be in a recession now, but it is clear it doesn't have a future without workers from overseas.'

"Latin American guest workers, whose Japanese parents and grandparents emigrated to Brazil and neighboring countries to work on coffee plantations.

"In 1990, Japan – facing a growing industrial labor shortage – started issuing thousands of special work visas to descendants of these emigrants. An estimated 366,000 Brazilians and Peruvians now live in Japan.

"The guest workers quickly became the largest group of foreign blue-collar workers in an otherwise immigration-averse country, filling so-called three-K jobs (kitsu, kitarnai, kiken – hard, dirty and dangerous).

"But the nation's manufacturing sector has slumped as demand for Japanese goods evaporated, pushing unemployment to a three-year high of 4.4%. Japanese exports plunged 4.4% in March from a year earlier, and industrial production is at its lowest level in 26 years.

"New data from the Japanese trade ministry suggested manufacturing output could rise in March and April, as manufacturers start to ease production cuts. But the numbers could have more to do with inventories falling so low that they need to be replenished with any increase in demand.

"While Japan waits for that to happen, it has been keen to help foreign workers leave, which could ease the pressure on domestic labor markets and the unemployment rolls.

"'There won't be good employment opportunities for a while, so that's why we're suggesting that the Nikkei Brazilians go home,' said Jiro Kawasaki, a former health minister and senior lawmaker of the ruling Liberal Democratic Party.

"'Nikkei' visas are special visas granted because of Japanese ancestry or association. Mr. Kawasaki led the ruling party task force that devised the repatriation plan, part of a wider emergency strategy to combat rising unemployment.

"Under the emergency program introduced this month, the country's Brazilian and other Latin American guest workers are offered $3,000 towards air fare, plus $2,000 for each dependent – attractive lump sums for many immigrants here. Workers who leave have been told they can pocket any amount left over.

"But those who travel home on Japan's dime will not be allowed to reapply for a work visa. Stripped of that status, most would find it next to impossible to return. They could come back on three-month tourist visas. Or if they became doctors or bankers or held certain other positions, and had a company sponsor, they could apply for professional visas."

William Krehm

Key Lessons *from page 13*

of our society committed to the notion of a self-balancing market and all government spending being dedicated to strengthening the control of deregulated banking. Among much else this involves an absolute dedication of universities being dedicated to:

2. Government budgets being balanced. *But without a basically correct system of accountancy how can one tell whether the books are really balanced?* Double-entry or accrual accountancy was brought back from Saracen land by a crusading order about one thousand years ago. Its basic principle is simple: every transaction enters the ledger of the investor twice – once its cost to him that is "amortized" over the expected useful life of the investment, and the corresponding asset value of the investment is initially entered at the same figure and is "depreciated." From there on they pursue their distinct paths subject to the revaluations of the investment to reflect the success of the investment. More or less, that system is in applied in the private sector. The "marked to market" that you have heard more of in recent months is merely adjusting the value of the depreciated asset value to its actual market value. That does not call into question the basic accrual accountancy that government insists on from its taxpayers.

But until 1996 in the US and 2002 in Canada, the government's own books were run in a way that denied the time of day to any serious accounting. The government debt was carefully "amortized" over the financing agreement, but the asset value of the investment was written off completely in the year in which the investment was made. Obviously that left a deficit that was not necessarily there. But that false deficit was enough to push interest rates into the skies.

At this point we must introduce a concept of François Perroux, a great French economist with whom I was closely associated – François Perroux – among much else developed the idea of a "dominant revenue." He defined it as the revenue of a class by its volume and rate is taken as the index of the well-being of society as a whole. In post Napoleonic Britain it was the income of the large landowners from agricultural produce grown behind high tariff walls that was the dominant revenue. Then after those tariff walls came down in 1832, it became the industrialists who wanted free trade because Britain was away out in front as sole industrial power and the doctrine of free trade or low tariffs, not only brought down the survival wage they paid their workers, but set an example through the British free trade advocates such as David Ricardo who spread it as absolute gospel.

That was a period when factory workers were largely illiterate and the labor theory of value was widely used by British economists in one form or another offered critics of the capitalist system that was coming in a powerful weapon. But by the latter half of the 1800s the working class of Britain had learned to read and the labor theory of value became unacceptable because of its revolutionary implications – a horrible example set by Karl Marx, and other continental rebels who had settled in Britain. Hence three economists almost at the same time in three different countries Britain France and Austria shifted the determination of the value of a product from the workshop to the sales counter.

And with a gross misuse of infinitesimal calculus, which they mistook *per se* as a guarantee of high science, they purported to solve economic problems with a price and value theory that derived entirely from the amount of enjoyment the user derived from the consumption of the product. An instance of the extent of the leap is available from this "marginal utility" disposal of unemployment. It was explained away with great elegance: there was no such thing. If the worker did not have a job it was just that as consumer he derived greater enjoyment from leisure in his parlor than going to work at the wage offered.

An Amateurish Misuse of Calculus

Economists came to assume that the amateurish misuse of calculus that they made endowed it with supreme scientific powers. But the empirical content of mathematics is zero: it is its power of analysis that is unbounded. There is a whole literature of great mathematicians and physicists that makes the point. But economists who have for decades done so have been banned from the staff of most universities in recent years.

The derivative crisis which is bedraggling the world and our universities today is a by-product from the conviction of the official derivative techniques not only for predicting the future but for swaps trading, that claimed to have guaranteed the wildest insurance against risk.

However, the point must be made that what is just risk may be insured, but what is dead wrong cannot be insured. For example 2 + 2 = 5 is not very risky. *It is wrong and*

Continued on page 20

The World Economy is Stood On Its Head to Prove that It Does Have Legs

It used to be, not that long ago, when China sedulously resisted keeping its huge positive trade balance in yuan but hastened to convert it into foreign currencies – mostly dollars – to keep the yuan low and its foreign exports, on which it depended so much, competitive. But all that has changed. And the change itself is evidence of the distrust that the dollar and the American economy have aroused.

That, however, is only one aspect of the US economic mess. And even *The Wall Street Journal* pays tribute to the greater ease and efficiency with which Beijing has organized its "institutions" to reverse the collapse of its economy than the US. We quote from its issue of 11/04 ("China Turns a Corner as Spending Takes Hold" by Andrew Batson): "Beijing – China's massive $585 billion government stimulus program appears to be kicking in, new data suggested Friday, raising the chances that the world's third-largest economy may be turning a corner.

"Chinese demand for raw materials, hard hit in past months, is showing signs of recovery, with crude-oil imports hitting a one-year high in March, the government imported record quantities of their key raw material, iron ore, in anticipation of a pickup in demand in coming months.

"Banks have extended $400 billion of new loans in the first two months of the year, and early signs indicate the boom continued into March. And the stock market, which had been battered, is on the rise, with the Shanghai Composite stock index gaining 2.7% Friday, giving it a 34.24% increase for the year.

"The signs augur well for the global economy. China has been one of the most voracious consumers of raw materials. While its aggregate spending plan reflects the power of its state-dominated economy, there are signs that its thrifty consumers are starting to spend more.

"Car sales hit a monthly record in March, according to figures issued Thursday marking the third consecutive monthly rise. The optimistic outlook has spread to businesses. The National Bureau of Statistics said this week that its survey of managers' confidence rose in the first quarter after plunging in the final quarter of 2008.

"Overall, it appears that the state's push has helped keep China from slipping into a downward spiral where poor economic conditions and declining confidence feed off each other. The impressive size of China's stimulus gets some credit for that: along with the US plan, it is one of the largest in the world. But the vestiges of China's command economy have also proved useful

"'China is unusual in that it has this incredible capacity to mobilize all its institutions,' said Vikram Nehru, the World Bank's chief economist for Asia. The government spending has meant its stimulus efforts have worked faster than many initially expected. 'There is now a growing degree of confidence that the stimulus efforts have worked faster than many initially expected.'"

Can the Memories of Communism Equip China to Keep Job Creation High Enough?

Of course, the comparison is made between the state controls inherited from the Communist period but contrasted with the Deregulated and Globalized regime installed to give the banks an unimpeded playground for its endless, unimpeded, exponential growth.

The contrast alluded to and picked up in *The Wall Street Journal,* of all places, reminds us of the revelation we carried in our review of the origins of banking that revealed that banking had preceded the development of money by at least some 2000 years. And after reading of the many different ways of handling credit antedating money, we are better prepared for this most unusual avowal of the *Journal.*

"Beijing's program still has considerable work to do, with new data also charting continual contraction in the country's export sector.

"Exports fell 17.1% in March from a year earlier, after a 25.7% decline in February, a reflection of China's vulnerability to weak economies in the US. That left a trade surplus of $18.56 billion for the month, far higher than February's figure but less than half the levels recorded late last year. The global slump in demand has battered

Chinese exporters, leading to millions of lost jobs.

"But the Chinese government is pushing cash through the economy, and the state investment program is driving hundreds of new infrastructure projects.

"The funds budgeted for investments that started in the first two months of 2009 surged 88% from a year earlier, the highest increase on record.

"Like China, the US government also has launched a significant fiscal stimulus, of $787 billion, the impact of which is only now beginning to show up in the economy, as tax cuts swell worker paychecks. US consumers – their retirement accounts and home values depressed – are showing a reluctance to spend as readily as they usually do. Car sales, in contrast to the record sales in China, are extremely low. Spending on infrastructure is taking a while to kick in, despite all the talk of 'shovel ready projects.' Weaknesses in US banks, and even more, the near paralysis of the important market for securitized credit, remain impediments to renewed economic growth.

"China needs support from demand in the rest of the world to sustain a recovery. Without that, it's still unclear that China's economic engine, having been jump-started by massive government investment is taking a while to kick in, can keep running at a higher gear.

"Export manufacturing remains the primary employer of China's 140 million rural migrant workers.

"About 20 million of them are unemployed, and if the export crunch continues for several more months, that could exhaust

Wall Street No Longer the Gate to Nirvana

The New York Times (18/04, "In Banking Downturn, Graduates Rethinking Future" by Steven Greenhouse) is causing some drastic changes in career planning of those planning futures of high finance. "Philadelphia – Riana Paige, an undergraduate senior at the Wharton School of Business, had a high-paying internship at JPMorgan Chase last summer and was disappointed when she did not receive an offer for a full-time job after graduation. Now she is pursuing a job teaching in Dubai, or working for a wine importer.

"Daniel Miller, a Wharton senior who interned last summer at a boutique private equity firm in Manhattan, became so discouraged by his search for jobs in finance that he began thinking about becoming a rabbi.

"Jessica Levy, also a senior at Wharton, the nation's most prestigious undergraduate business program, was stunned when her supervisor at UBS told her that although she had done a terrific job as an intern, the bank could not offer her a job after graduation. Her dreams of investment banking quashed, she recently took the Foreign Service exam and is vying for a job in the State Department.

"'A lot of my peers, we're exploring things that we did not even think of as an option,' Ms. Levy said.

"A finance major who was minoring in music was suddenly looking into opening a jazz club. 'All of a sudden I saw that a lot of Wharton people were interesting.'

"For the last decade, a job at Goldman Sachs, Morgan Stanley or another investment bank has been considered the coveted prize of the nation's best and brightest college students. But the implosion of Wall Street – the vaporization of Bear Stearns, and Lehman Brothers, the general humbling of investment banks has not only shaken a generation of ambitions, but also unleashed them.

"'There was a real herd mentality to get into investment banking,' said Ms. Levy, noting that prestige, peer pressure, and parents often channeled students to Wall St. 'But because of this crisis, there was suddenly permission to pursue something that you were interested in that your parents three years ago would have said no to.' For many students at Wharton, part of the University of Pennsylvania, the Wall Street crisis has fostered a sense of relief. Some students now acknowledge that they were pursuing investment banking jobs largely to placate parents who, having invested nearly $200,000 in their children's educations, were eager fir them to earn top dollar – and some prestige too.

"Of course, the prestige firms that remain are doing plenty of hiring, although substantially less than in years past. And some finance majors shut out of Wall Street jobs have accepted back-up options, often lesser banks in smaller cities. But many who thirsted for big investment banking houses are looking at decidedly down-market alternatives, everything from Teach for America to computer engineering.

"College officials say that the sweeping changes on Wall Street will affect not only finance-minded members of the class of '09 but also tens of thousands of juniors, sophomores and freshmen, leading them to rethink their career goals.

"After doing an internship at Goldman Sachs last summer and not being offered a full-time job there, Katie Shea, a senior at the Stern School of Business at New York University, is instead pursuing her dreams of entrepreneurship. She has founded a shoe company that designs and imports collapsible shoes that women can wear while walking to work and then stuff into their pocketbooks."

"'For me, the Wall Street crisis was a blessing in disguise,' she says. For many undergraduates with their eyes on Wall Street, the financial sector created confusion in their searches. Ms. Levy says she interviewed at Lehman Brothers one day, and it filed for bankruptcy the next day.

"At Wharton, the number of on-campus interviews for the school's 600 undergraduates fell 20 percent, from 13,000 last year. Last year, starting salaries for undergraduates going to top financial firms typically ran from $55,000 to $70,000, with an $8,000 signing bonus. And their annual bonus often equaled their starting salary. This year, starting salaries are roughly the same, with signing bonuses often falling to $4,000. As for expectations of fat bonuses, they have gone the way of Bear Stearns.

Daniel Miller, the student who was contemplating rabbinical school, had suspended his job search, intent on savoring his last few weeks before graduation.

"'I'm fortunate I don't have any college debt and have a very supportive family. I can't imagine what it's like for anyone less fortunate than me.' But last Thursday, a real-estate investment firm outside Philadelphia offered him a job. 'Rabbinical school can wait.'"

But it is not quite that simple. Surely the way humanity is heading, with the omnivorous speculative banking sector gobbling up everything in sight, we need the help of all the gods of every faith to keep humanity from being devoured.

W.K.

their families' meager savings.

"Key to the effectiveness of China's stimulus plan so far has been a race by local government to spend the money.

"After November's stimulus program gave them the go-ahead, authorities in the northern city of Harbin started expanding their port in March. The provincial government has even more ambitious port plans it is trying to launch by October. 'Thanks to the stimulus plan, our proposed projects get a lot of support from the central government,' one official in Harbin said.

"In central China, the state-owned Henan Coal & Chemical Industry Group started work on 15 expansion projects on April 1, declaring its planned spending of 22.4 billion yuan – a response to the government's call to maintain 8% growth this year.

"That kind of reaction is partly why many analysts expect first-quarter economic data to show activity picking up relative to the fourth quarter of 2008, even though growth rates remain very low by Chinese standards. 'I think it's fair to say the economy has bottomed. But bottoming is not recovery,' said Ben Simfendorfer, an economist at Royal Bank of Scotland.

"Among the reasons for economists' caution before calling a recovery is that China has had at least one false dawn in recent months. In early anticipation of stimulus-related orders, domestic steelmakers started ramping up production in December to push up prices and freight rates. But the anticipated demand didn't materialize, and steel prices have been falling since February.

"The stimulus, however, at least gets credit for stemming panic."

In another article that will appear in the June issue of *ER* I will deal with the successful achievements in our past history and economic practices, that will have to be restored, before we can consider the world on the way to economic recovery.

W. Krehm

Deflation in Spain Rings Alarm Bells on What Globalization Is About

The New York Times (21/04, "In Spain's Falling Prices, Early Fears of Deflation" by Nelson D. Schwartz) leaves some questionmarks over the very concept of globalization. "Valencia, Spain – Faced with plunging orders, merchants across this recession-wracked country are starting to do something that many of them have never done: cut retail prices.

"Prices dipped everywhere, from restaurants and fashion retailers to pharmacists and supermarkets in March. Hoping to increase sales, Fernando Maestre reduced prices by a third on the video intercoms his company makes. But that has not helped, so, along with many other Spanish employers, he is continuing to fire workers.

"The nation's jobless rate, already a painful 15.5%, could soon reach 20% a troubled number for a major industrialized country.

"With a combination of rising unemployment and falling prices, economists fear Spain may be in the early grip of deflation, a major concern since the financial crisis went global last year…. Mr. Maestre is already contemplating additional job and wage cuts for his 250 employees.

"Nowhere is this cycle more evident than in Spain. Last month, it became the first of the 16 nations that use the euro to record a negative inflation rate, though just 0.1%. Spanish officials said it could keep dropping through the summer."

The problem is in fact far more serious than appears from the article quoted, because the very concepts of "inflation" and "deflation" used are hopelessly flawed. It is true that if you have more demand than can be satisfied by the available supply, prices will go up, and that will be real "inflation." But you cannot turn a proposition around and automatically assume that it remains valid. If I shoot myself in the head, I will fall dead, and that will be suicide, but from that I cannot assume that if I fall dead, I have suicided. It could be due to heart failure or one of dozens of other causes. That is quite a simple blunder for economic theory on which the survival of our society depends. Yet no economist contemplating moving from a town of, say 10,000, to New York, is fool enough to expect his cost-of-living to remain the same. Yet in their use of "inflation" to designate the price effect when humanity as a whole makes such a move, that is precisely what economists do.

It is a good forty years since I reached the conclusion that the higher degree of government capital investments in both physical and human capital investment, has created a deepening layer of price, that has nothing to do with an excess of demand over supply, but was caused by more capital investment in physical and human infrastructures being made by the government and paid by taxation, which thus constitutes an ever deeper layer in price. This I called "the social lien." My paper was carried the leading French journal on economic theory at the time – *La Revue Économique* – and commented upon favorably by at least a half dozen academic publications.

Many of these publications have since disappeared. To understand how and why, I must bring in the work of a great French economist, of that day, with whom I came to be associated, François Perroux. It had to do with the "dominant revenue." It maintained that in every society the revenue of a group in the saddle economically is taken to be the fitting index, in its volume and rate, of the welfare of that society as a whole. When a class forfeits that position of its revenue, the dominant revenue shifts to a new such class or sub-class. Thus after the Napoleonic Wars the large landowners in Britain who prospered behind high tariff walls protecting the prices of agriculture produce. But that led to what the emerging class of industrialists considered excessively high subsistence wages they paid their factory workers. The removal of those tariffs in 1832 marked the shift from the landed gentry to the industrialists. In our own day – specifically after WWII – the dominant revenue shifted to speculative finance.

That explains why in the entire program announced by President Obama, there is not even a hint of the basic key legislation under President F.D. Roosevelt, that made it possible to restrict the banks to banking and – through the *Glass-Steagall* law banned the banks from acquiring interest in the non-banking financial pillars – notably stock brokerages, insurance and mortgage companies. The significance of that? Allow the banks to get their hands on the cash and near-cash (interest-bearing short term loans), and they will use them as money-base for their own money creation. That not only provides increased leverage, but moves on from one such level of take-over to the next, with the end result of a soaring sky-scraper that can only move only upwards, with the elevator never going down, and the speed ever increasing until the ultimate disaster that we are approaching at the moment.

It is significant that in all the concern over the deepening crisis, there has not been a hint in the pronouncements of those who have taken over President's policy-making to apply the lessons that served to start the United States moving out of the Great Depression. Not only the *Glass-Steagall* law, but the statutory reserves that required the banks to redeposit with the central bank a portion of deposits received from the public on an interest-free basis. That was an important detail in the Rooseveltian package, since it made it possible to "cool" an over-stimulated economy by increasing the *amount* of the statutory reserve without increasing the benchmark interest rate. That smoothed the cutting edges at least of the "dominant revenue" – interest rates. Once the statutory reserves were removed there was no alternative in the official package but moving the benchmark interest rate up until prices along with the whole economy lay prone.

And, of course, the notion of using the central bank – whether nationalized or still in private banks' hands – for at least the capital investments – physical and human – of the public sector has long since been buried.

But there is more than enters the policy mix of government policy than economic considerations. Undoubtedly, part of the generous immigration policy of Spain today – particularly towards immigrants from Latin America has to do with both an awareness of a long-disappeared common allegiance and a common culture. And in the current regime a social sensitivity to wipe out the memory of the Franco decades. In good years it paid off, and many of the immigrants from Africa and Latin America that reached Spain eventually found their way to the other less socially sensitive regimes within the European Union. And of course, the requirement of the EU that its members do not run up a deficit exceeding 3% – even with the faulty bookkeeping that does not recognize investments of the government for what they were proven to be on the basis of the German and Japanese experience.

One need only contrast the Japanese treatment of their Brazilian and Peruvian immigrants of Japanese descent with Spain's handling of African and Latin American immigration to get the point.

It would help immensely for governments to be allowed to respond to their human ties and to their own history in making this a more habitable planet.

William Krehm

Are We Too Busy Globalizing the World to Look After Our Municipal Water Supply?

The New York Times (18/04, "In Aging Water Systems, Bigger Threats Are Seen" by Michael Cooper) sounds the tocsin: "Chelan, Wash. – It has been a thousand years since the Romans built their aqueducts, and 200 years since Philadelphia pioneered the use of cast-iron water mains in this country. But the 6-inch-wide city pipe that still delivers drinking water to a block on Nixon Street here for uses an even more primitive technology: wood.

"The pipe's wooden planks are lashed together with a coil of metal as if each section were a long, narrow barrel, and [that] is not unique to Chelan.

"Water officials say they believe that a handful of wooden water mains are still in use in Alaska, Pennsylvania and South Dakota, among other places. The old wood pipes offer a vivid reminder of the age and fragility of the nation's drinking water systems, many of which rely heavily on old pipes that often remain out of sight and mind – until they burst.

"Or could it be that our governments are so immersed in setting constitutional and sexual relationships aright [to say nothing of Iraq and Afghanistan] – an enterprise that both Alexander the Great and the British Empire at the very height of their glory abandoned, that it hasn't the resources and the time of day to trouble about municipal problems back home. Yet let no one tell you that pipes that deliver water to our nation are anything but a critical concern for our society's survival.

"And pipes of all kinds are bursting with alarming frequencies in systems coping with septuagenarian, octogenarian, and even century-old pipes. There are an estimated 340,000 water main breaks each year in the US, according to the Environmental Protection Agency's Aging Water Infrastructure Research Program, and some water experts fear that the problem is getting worse.

"D. Wayne Klotz, the president of the American Society of Civil Engineers, has warned that the breaks not only waste millions of gallons of clear drinking water, but can also cause tremendous damage, pointing to a major break in Maryland late last year that stranded motorists on a flooded road. When most people think of a leak, they think of a drip in their sink. These are not like that. They were rescuing people by helicopter!

"The new federal stimulus law provides $6 billion for water projects, with $2 billion of that directed to drinking-water systems. But the EPA estimated that the nation's drinking-water systems require an investment of $334.8 billion over the next two decades, with most of the money needed to improve transmission and distribution systems."

We must ask what sort of research and accountancy do our national governments apply to decide what sense it makes to reform Afghanistan's sexual and religious arrangements, when our government is flying blind about infrastructure needs for survival at home.

"This winter water main breaks have stranded drivers on washed-out roads around the nation, caused a mudslide in California and flooded school libraries in Minnesota and Texas. Last month, just after Gov. David A. Paterson attended the opening of a new subway station in Lower Manhattan, service to the subway line was suspended when a water main installed in 1870 burst, flooding the tracks. A break in Niagara Falls, NY, spewed some 11 million gallons of water."

A Ticking Time Bomb

"Failing pipes plagued Warren, Mich., just outside of Detroit, this winter. After the city suffered 107 breaks in the course of a particularly cold month – three time as many as the average – Mayor Jim Fouts declared a state emergency so that he could hire outside workers to help his overwhelmed city crews. A break outside a shopping center created a sinkhole that engulfed a van and left the center without water for three days.

"'Everybody's been looking the other way, and we have this ticking time bomb that's ready to go off,' Mr. Fouts said, pointing out that many municipalities spend their scant resources on more visible needs, like street work, rather than on costly pipe repair and replacement.

"'So there is plenty of competition for

the federal drinking-water money. When the State of Ohio asked for suggestions on spending its stimulus money, mayors and city managers put in some 1,400 requests for drinking water projects costing a total of $3 billion,' said Melissa Fazekas, for the Ohio Environmental Protection Agency.

"Many of those requests sound like pleas. Managers of villages and cities complained of losing a quarter or even half of their drinking water to leaky pipes. One official said that his village's aging pipes had burst or sprung leaks 20 times since November. Others lamented that water main breaks regularly forced them to order their residents to boil water to avoid contamination.

"With many systems showing their age, the American Water Works Association has termed this 'the dawn of the replacement era.' Many localities find themselves having to replace miles and miles of pipe for the first time – a burden that is especially acute in poorer industrial areas with shrinking populations, where such work would require higher-than-average water-rate increases on the residents who remain.

"When it comes to pipes, however, newer is not necessarily better, the association has found. The oldest cast-iron pipes, dating to the late 1800s, have an average useful life of about 120 years. For cast-iron pipes installed in the 1920s, that drops to 100 years. And pipes laid after World War II, the city's director of public works, have an average life of only around 75 years.

"And speaking of repairing wood pipe that still are to be found scattered around the country, Dwane Van Epps, the city of Chelan's director of public works, said he planned to replace the last 500-foot section of wooden pipes before it fails. For replacing wood pipe combines carpentry with plumbing. 'It's kind of finicky work."

W.K.

P.S. And then, of course, all that is lacking to add to the disarray is for the Fed to push up interest to deal with what it calls "inflation" because prices due to the higher costs both of dealing with the cost of boiling water and the higher municipal taxes, even without the increase in interest rates to "lick inflation." Faulty accountancy inspired by the caste-interests of speculative finance manages to exploit every emergency.

How the Present Crisis of Our Auto Industry was Foreseen Some Six Years Ago

While proofing volume three of Meltdown, *I noted how well COMER had foreseen the depths to which our automobile industry was headed. Obviously our view of the economy enabled us to foresee what the government, our central bank and the industry economist had shut their eyes to, as they are doing once again.*

From Economic Reform *of October 2002 we reproduce the following:*

Have we Already Begun Blowing the Next Bubble?

The soap suds are stirred, the clay pipe is at hand. The clay gods who preside over the ritual are intact at their altars. The world has not begun coping with the last bubble-burst, and Wall Street is busy preparing the next.

To understand its compulsion, an introductory word. No one has to be told that the world has become terrifyingly complex except orthodox economists. The key way in which they avoid recognizing that unpleasant fact is by the liberties they allow themselves with the time dimension. Time is what links our past and future with the present. That means that we must distinguish what took place in the past from what is taking place in the present. And of the future we have at best only very imperfect knowledge. And yet the future is the happy hunting ground for securities salesmen, bagmen and promoters. The least we can do is get a firm grasp on how the future feeds into the present. And on what might occur in the future that can conscientiously be presented as a present asset. Graphically this could be shown by arrows: one directing from the past to the present, the other from the present to the future. This is the simplest instance of one-dimensional analysis. And it is one that, scandalously disregarded, has contributed to the world's current crisis. If you distort the way in which the future affects our present, you are blowing soap bubbles. And hardly with the innocence of a child.

Instead of arrows leading from the past to the present, and from the present to the future, we end up with a dot that has no dimensions. Otherwise expressed, instead of analysis, we are lost in number-crunching that essentially ignores that great spoiler – the time dimension. Let me give you a couple of examples.

The treatment of capital investment in the public sector. Rather than writing investments off over their period of economic usefulness (depreciation) and noting the repayment of the monetary cost (amortization), the investment itself was until recently wholly written off as a current cost in the first year after it was made. If this were done in the private sector, most companies would appear bankrupt, and corporations would certainly be prosecuted for avoiding taxes.

As for households, it would be equivalent to calculating your net worth by recording the mortgage on your home as a debt, but omitting the asset value of the house to offset it.

Contrast this with the practice of corporations capitalizing not only their anticipated flow of earnings in the future, but also their anticipated market share. Especially in the case of high-tech corporations, it didn't seem to matter whether that market share has been achieved by selling their products at a loss, but founding their plans for success by their conquest of market shares.

If similar accountancy were done by households, the householders net worth would record their net worth by recording the outstanding balance of the net value of their mortgages as a debt, omitting the value of the house to offset that.

Contrast that with the practice of automobile corporations capitalizing not only their anticipated flow of future earnings, but their anticipated future market share. The assumption is that after achieving a dominant share – say a modest 100% – the competition will be stone-dead and then your firm's prices can be raised to bring in handsome profits. This obviously is a grotesque new instance of John Maynard Keynes's "Fallacy of Composition." The story-line, if realized, might work for the victorious corporation, but it involves all the competition going broke. Hence passing from the individual to society as a whole, the result would be disastrous. Today we are witnessing the hopelessly deflated market for fibre optical inventories which has left no victors.

The Wall Street Journal (9/9, "While Auto Makers Sputter, their Dealers Go Full Throttle" by Karen Lundergaard):

"At a time when Detroit's big auto makers are scrambling to slash costs to rebuild razor-thin margins and are watching their stocks get hammered, many car dealers are prospering.

"With auto makers pumping money into the costly promotions that have consumers thronging to dealerships retailers are enjoying some of their best years ever, Stocks of the big publicly traded dealership groups such as AutoNation Inc., based in Fort Lauderdale, Fla. and Dallas-based Group 1 Automotive Inc. have more than doubled during the past two years, while auto makers shares are down as much as 50%.

"The divergent fortunes of car dealers and car makers add up to a striking anomaly of today's shaky economy. In past downturns, when car-makers saw demand sliding, they cut production, and even, in some cases scaled back discount deals to ride out the storm. Car dealers suffered along with the factories.

"Now auto makers face a different landscape. Even with strong sales, the North American auto industry, including the overseas plants that feed it, still can make about 20% more vehicles than the 17 million or so than they can sell each year. Any producers that pulls back risks a long-term loss of market share, if rivals choose to fill the gap."

In short with their present profitless production, automakers are just keeping warm their chairs for future profit-making.

"For Detroit's Big Three, scaling back production saves much on labor anyway, because union contracts in the US make labor a fixed cost in effect. And cutting production means less cash coming in the door to finance growing pension obligations."

In the Greek legend, Sisyphus in Hades rolled his rock uphill each day, only to have it roll back each night for all eternity. But at least, he didn't have to worry about meeting a payroll and keeping his bank at bay.

"So the car makers have been poring over the discounts to keep production moving, and customers have been snapping up the output in a surprisingly robust level of spending.

"But as the Big Three have used ever-deeper discounts to protect market shares, they have seen their profit margins shrivel. GM says its deals this summer cost the company at least as much as the sweeping 0%-financing it rolled out as an emergency measure to resuscitate sales after 9/11…. Despite the sales boom, the Big Three have announced plans to cut more than 50,000 jobs and suppliers are facing new demands to lower prices.

"And Toyota and Honda have cut dealers' margins over the years – charging them more for the cars."

"Also manufacturers foot the bulk of the marketing bill to sell cars. AutoNation's Mike Jackson estimates that the manufacturers spend about $2,500 on incentives and $500 on advertising and other marketing, while AutoNation is spending just $300 per vehicle. At the same time – low interest rates keep down inventory expenses – one of dealers' biggest costs."

No Escape from the Gloom

The day after carrying this report, *WSJ* carried a story (10/9, "Ford Expects to Post 'Small Profit' for Third Period, Beating Forecasts" by Joseph B. White and Norihiko Shirouza) with the following incredible tidings: "Ford's market capitalization of $9.7 billion is less than the $24.9 billion in gross cash the company has on its books. That means investors are effectively assigning a negative value to Ford's $131.5 billion a year automotive and finance business." More gloomy epitaphs are rarely found on tombstones. And this tombstone is over an economic system rather than over any particular exponent of it.

And into this china shop, Governor Dodge of the Bank of Canada has barged with higher interest rates – yesterday's rule of big-toe for fighting "inflation."

"The publicly traded dealerships have spent the past couple of years trying to distance themselves in the eyes of Wall Street from the ailing car makers. They present themselves to analysts as specialty retailers, along the lines of home improvement chain Lowe's Companies Inc. rather than auto companies."

What this amounts to is another derivative bubble. The dealerships are a derivative of an already-bursting bubble – the auto companies. They are packaging a future that cannot survive the disappearance of the supporting bubble – the auto companies. Obviously, when the bankers of the manufacturers force the auto companies to throw in the towel and write off their bad loans, there will be no one to make up the deficits that are fuelling the dealership boom. Once again – as in the case of the fiber optics conglomerates, there is no serious communication between the two.

William Krehm

P.S. There is an important corollary to this simple exercise in one-dimensional analysis. The collapse of the international financial system leaves society with a numerous tribe of highly overpaid people with no other skills or training than buccaneering on as highly manipulated world securities market. No economic revival worthy of the name can be fashioned around the priority of finding gainful employment for jobless high executives at the lofty remuneration to which they have become accustomed.

Deregulation and Globalization was conceived with little concern for the tens of millions that were deprived of their livelihood and even of their savings. In reshaping the world to more sustainable activities, more humanity should certainly be shown in helping these unhappy unemployed high executives to more useful careers. But ways of achieving this must be undertaken at once. Returning infrastructural assets to the state where privatized companies are in trouble can be helpful in this respect. Significantly, the British government has bailed out British Energy PLC to the tune of $998 million to help it meet its immediate financial obligations which include 82.4% of Bruce Power.

The share power of the mother company fell 65% in a single day. And it seems that there is desperate need for deprivatizing the eight nuclear reactors in Ontario rather than having the financial markets take over further public assets.

But first and foremost that involves rethinking what has passed for economic theory over the past quarter of a century. For that is now exposed to have been little more than the battle hymn of the world's stock markets elevated to the dominant economic group.

Key Lessons *from page 15*

hence non-insurable, like a house already on fire. Yet our present deep crisis is due to the failure of official economics to make the distinction. At most of the academic conferences I have attended, participants were not encouraged to question the scientific basis of derivatives and derivative swaps. And yet as employed by our deregulated bankers under the alleged protection of derivatives the insurance companies were using the very mathematics – exponential growth – that were the maths of the atomic bomb.

There is clearly a bit of rethinking of exponential growth that is greatly overdue. And that is why we regret to see that President Obama has put the review and remaking of US economic policy in quite the wrong hands.

William Krehm